FILED
JUN 8 1953
HAROLD B. WILLEY, Clerk

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 850 108

ADWOOD CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

RICHARD BENTLEY,
JACKSON L. BOUGHNER,
MEYER FIELD,
Counsel for Petitioner.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No.

ADWOOD CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Adwood Corporation respectfully shows:

(1) *Statement of Matter Involved*

The petitioner filed a petition with the Tax Court of the United States, praying for a redetermination of its income, excess profits, and declared value excess profits taxes for the fiscal years ended May 31, 1942, 1943 and 1944. The respondent had proposed net deficiencies for these three years totalling $58,931.20. The sole cause of the proposed deficiencies was the disallowance of certain depreciation claimed by the petitioner on its hotel building and equipment.

The petitioner is the owner of a hotel in Detroit, Michigan, known as Hotel Detroiter. The building was erected in 1928 on land leased for ninety-nine years to Savoy Hotel Company (R. 50). Construction was financed principally by first mortgage bonds in the total amount of $1,450,000 secured by a Trust Indenture (R. 51).

In April of 1929, the lessee, Savoy Hotel Company, defaulted in the payment of ground rent. In an agreement of July 1, 1929, between the lessors and the lessee, all unpaid rent for 1929 was waived, and the lessors were given the right to immediate possession if there was a default in payment of interest on the First Mortgage Bonds. In December of 1929, Savoy Hotel Company defaulted in the payment of such interest. On December 14, 1929, the Trustee under the Trust Indenture served a notice of intent to foreclose on both the lessors and the lessee. On December 26, 1929, the lessors served a seven-day notice to quit on the lessee, and on January 6, 1930, took possession of the property. Savoy Hotel Company, the lessee and owner of the building, brought an action to regain possession. The Court held the lessors entitled to possession under the agreement of July 1, 1929, but went on to hold specifically that the lease had not been terminated, and gave the lessee until March 26, 1930, to reinstate itself under the lease. This was by virtue of a specific provision in the lease under which it could not be terminated until 90 days notice had been given (R. 52). The lessee did not reinstate itself (R. 53).

On March 1, 1930, the Trustee secured operating control of the property through an agreement with the lessors (R. 53). In June of 1930, an action of foreclosure was commenced, resulting, on June 10, 1941, in a sale to the petitioner corporation, which was formed by the bondholders (R. 54).

The original cost of the hotel building, less depreciation to June 10, 1941, was $1,630,000 (R. 47). The petitioner claims the right to compute its depreciation on this figure. The Government allowed depreciation only on the upset price at the foreclosure sale of $400,000. It has been stipulated that the allowable depreciation on the $1,630,000 figure is $48,900 annually (R. 47).

As can be seen from the foregoing statement, the affairs of the Savoy Hotel Company followed the regular pattern of insolvency reorganizations. The only significant variation was the termination of the ninety-nine year lease, after notice of intent to foreclosure had been served and operating control secured, but prior to the actual bringing of court action and sale.

The petitioner contended that what took place was an insolvency reorganization as defined in section 112(b)(10) of the Internal Revenue Code (See Appendix). The government contended that since bare legal title was lost by Savoy Hotel Company prior to the time of actual filing of foreclosure papers in court, that section was not applicable.

The Tax Court found for the respondent, holding that the debtor had lost title by the time of the foreclosure sale in 1941, and hence the petitioner had not acquired the building through a corporate reorganization.

The petitioner appealed to the Court of Appeals for the Sixth Circuit, which affirmed the decision of the Tax Court.

Petitioner presents to this Court and files herewith as an exhibit hereto, a duly certified transcript of the entire record in the case, as the same appears in the United States Court of Appeals.

(2) *Basis of Jurisdiction of this Court*

The jurisdiction of this court is invoked under section 1254 of Title 28 of the United States Code.

The judgment of the Court of Appeals sought to be reversed was entered December 23, 1952. The petition for rehearing was denied on March 10, 1953. The opinion is reported in 200 Fed. (2d) 552.

(3) *Question Presented*

The question presented by this petition is:

Did petitioner acquire the property of Savoy Hotel Company in an insolvency reorganization as defined by Section 112(b)(10) of the Internal Revenue Code, entitling it, under Section 113(a)(22), to use the cost of the property to Savoy Hotel Company as its basis for computing depreciation for the fiscal year ended May 31, 1944?

The Court of Appeals failed to rule on this question, although squarely presented to it on brief, argument, and in a motion for rehearing.

(4) *Reasons for Allowance of Writ*

(a) The decision of the Court of Appeals in this case is in conflict with the case of *United States* v. *Warwick Hotel, Inc.*, 158 Fed. (2d) 961, decided by the Court of Appeals for the Fifth Circuit in 1946.

(b) The decision of the Court of Appeals in this case is in conflict with the decision of this Court in the case of *Helvering* v. *Alabama Asphaltic Limestone Co.*, (1942), 315 U.S. 179, and misapplies the decision of this Court in *Bondholders' Committee, Marlborough Investment Co.* v. *Commissioner*, (1942) 315 U.S. 189

(c) The Court of Appeals did not consider in any way the application of Sections 112(b)(10) and 113(a)(22) of the Internal Revenue Code, which were remedial statutes enacted in 1943, "to resolve some of the doubts and uncertainties which result from existing law as construed in the Supreme Court decisions." (Conference Committee Re-

port on Revenue Act of 1943, 1944 C.B. p. 1063). This is an important question of federal law which has not been, but should be, settled in this Court.

It is submitted that these reasons call for the exercise of this Court's power of review.

WHEREFORE the petitioner respectfully prays: That a writ of certiorari be issued out of and under the seal of this Court, commanding the United States Court of Appeals for the Sixth Circuit to certify and send to this Court for its review and determination on a day certain named therein a complete transcript of the record in the case, numbered and entitled on its docket as No. 11318, Adwood Corporation, Petitioner v. Commissioner of Internal Revenue, Respondent; that the judgment of the Court of Appeals may be reversed by this Court; and that the petitioner may have such other and further relief as seems just.

ADWOOD CORPORATION, *Petitioner*,
By RICHARD BENTLEY,
JACKSON L. BOUGHNER,
MEYER FIELD,
Attorneys for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions of the Courts Below

The opinion of the Tax Court is found in 15 T.C. 148 and appears at page 49 of the record. The opinion of the Court of Appeals is found in 200 Fed. (2d) 552, and appears at page ——— of the record.

Jurisdiction

The decision and judgment below were rendered on December 23, 1952 and a petition for rehearing was denied on March 10, 1953. The jurisdiction of this Court is invoked under section 1254 of Title 28 of the United States Code.

Statement of the Case

The salient facts are contained in the foregoing petition and are hereby adopted and made a part of this brief. The case was submitted to the Tax Court in a short stipulation of facts (R. 44-48) with exhibits attached. The exhibits have been transmitted to the Court, but reference is made to the Tax Court's opinion for certain of the facts in order to avoid reference to the exhibits at this point.

Specification of Errors

The Court of Appeals for the Sixth Circuit erred:

1. In affirming the decision of the Tax Court of the United States which was for the respondent.

2. In holding that a loss of bare legal title, after service of notice of intent to foreclose and securing of operating control, makes inapplicable the corporate reorganization provisions of the Internal Revenue Code.

Argument

a. *Introduction*

Savoy Hotel Company secured a ninety-nine year lease to a valuable plot of ground. It issued $1,450,000 of bonds to finance the erection of a hotel building. In 1929 it defaulted under the Trust Indenture securing the bonds. The trustee of the bond issue started foreclosure proceedings and secured operating control. The lessors cancelled the lease. Eleven years later, the petitioner, a corporation formed by the bondholders, bought in the property at the foreclosure sale. At that point, the property had a remaining value of $1,630,000, and an indebtedness of $200,000. For their bonds of $1,450,000 the bondholders received property with a remaining net value of $1,430,000.

The government's position is that the property should have a value for tax purposes of $400,000. The security holders in this case would experience a 72% loss as a result of the harshest kind of technicalities. The ultimate loss of a bare legal title, devoid of substance, would wipe out 72% of the value about which there would have been no dispute if the bare legal title alone had been retained for but a brief period. On the morals, equity, and law, this result should not take place. If the government prevails, it will receive a windfall. The mere changing of position from bondholder to stockholder should not lead to such a catastrophe. There is nothing in the law that makes it compelling for the court to reach such a conclusion.

The course of events here is a familiar one. Variations of it have come before this Court on several occasions. The general rule, that an insolvency reorganization is no different from any other, and that the new corporation can use the basis of the old, was laid down in *Helvering* v. *Alabama Asphaltic Limestone Co.* (1942), 315 U. S. 179. Later

decisions turned on various technicalities, and in 1943 Congress enacted statutes designed to clear away these technicalities. These are found in Sections 112(b)(10) and 113(a)(22) of the Internal Revenue Code, and are set forth in full in the appendix. Briefly, they provide that where property of a corporation is transferred in a foreclosure or similar proceeding to a corporation organized to effectuate a plan of reorganization, no gain or loss is recognized and the new corporation is entitled to the old corporation's basis for depreciation purposes.

The only question presented is whether the cancellation of the ground lease as of March 26, 1930, takes the case out of these statutes. In his briefs in both the Tax Court and the Court of Appeals, the only claim made by the respondent that *any* requirements of the above statutes were lacking, was the requirement that the property be "property of a corporation". In neither the Tax Court's opinion nor that of the Court of Appeals, was there any reference to the absence of any other requirement.

b. *The Alabama Asphaltic Limestone Co.* case

In the *Alabama Asphaltic Limestone Co.* case, *supra*, the facts were similar. An insolvent corporation was thrown into bankruptcy; the property was sold to four individuals, who in turn transferred it to a new corporation. This new corporation claimed its predecessor's basis for depreciation purposes.

The government, in that case, urged that there was no continuity of interest between the old corporation and the new, and that the property involved was not property of a corporation at the time of transfer. This Court dismissed both arguments, holding that at the time the creditors took steps to enforce their demands, they stepped into the shoes of the old stockholders. The Court dated the acquisition of the

property back to that time, ignoring the intervening procedural steps.

In the instant case, the creditors took two steps before their debtor lost title. In December of 1929, acting through their Trustee under the Indenture, they served a notice of intent to foreclose. On March 1, 1930, the Trustee entered into an agreement with those in possession, under which all operating receipts were paid to it, and it made all operating disbursements. It was not until March 26, 1930, that the bare legal title passed to the lessor under the ninety-nine year lease.

If this case is so similar to the *Alabama Asphaltic Limestone* case, for what reason did the court below fail to follow that case? The answer is simple. Both the Court of Appeals and the Tax Court misapplied the case of *Bondholders Committee, Marlborough Investment Co.* v. *Commissioner* (1942), 315 U. S. 189, and refused to follow the case of *Warwick Hotel, Inc.* v. *United States* (D. C. Texas, 1945), 69 Fed. Supp. 242, affirmed (C. C. A. 5, 1946) 158 Fed. (2d) 961.

c. *The Marlborough Investment Co.* case

In the *Marlborough Investment Co.* case, *supra,* a corporation issued bonds on May 20, 1927, secured by a mortgage on an apartment building. On December 31, 1928, the property was transferred to F. S. Stimson Company, from which it passed to State Developers, Inc. On May 13, 1932, State Developers, Inc. transferred a one-half interest to Russell L. Cooley. Foreclosure proceedings were instituted August 26, 1932, resulting in a sale on September 30, 1933. On these facts this Court held a corporate reorganization had not occurred, because long prior to the initial default and institution of foreclosure proceedings, the original debtor had ceased to own the property. The case is obviously not in point.

The Court of Appeals, however, misinterpreted the case. In its opinion, it stated, referring to the Marlborough case,

> "There, while foreclosure proceedings were pending the issuing corporation had deeded the property to others."

In its petition for rehearing in the Court below, petitioner brought to the Court's attention this incorrect statement of the facts in the Marlborough case, but the petition was denied without opinion. If the decision in the Marlborough case had in fact been based on a transfer during pendency of foreclosure proceedings, that decision would be controlling here. Since the transfer there actually took place four years before default, the holding in the Marlborough case is not in point.

In almost every case of this type, there are one or more transfers during the insolvency proceedings. In the *Alabama Asphaltic Limestone Co.* case, there were three transfers: first, to the trustee in bankruptcy; second, to the creditors committee; and third, to the new corporation. All such transfers are, of course, subject to the lien of the first mortgage bonds, and in no way change the ultimate result.

d. *The Warwick Hotel* case

In our case, there was a temporary acquisition of title by the lessors, who were never successful in having their title ripen into full ownership. In the *Warwick Hotel Co. Inc.* case, *supra,* there was a temporary acquisition of title by the holder of a second mortgage, who, likewise, never owned more than a cloud on the title.

In that case, upon default occurring on a first mortgage, a notice of intent to foreclose was served, and operating control secured by agreement with those in possession. Then, before actual court proceedings were instituted, the second

mortgage was foreclosed, and bare legal title, subject, of course, to the first mortgage, passed to an individual. Thereafter the first mortgage was foreclosed and the property sold to a corporation formed by holders of the first mortgage bonds.

There, as here, the government advanced the argument that the issuing corporation had lost its title prior to the foreclosure sale and hence a corporate reorganization had not taken place. The taxpayer there was luckier in its choice of courts. Both the District Court and the Court of Appeals for the Fifth Circuit found no difficulty in distinguishing the Marlborough case.

The Court of Appeals for the Sixth Circuit, with a wave of the judicial wand, called the Warwick case distinguishable, but failed utterly to explain the distinction. In its brief in the lower Court, the government admitted the conflict with the Warwick case stating, with reference thereto " . . . . we submit that it is erroneous and should not be followed". (Brief for Respondent, Court of Appeals, P. 12). There is a definite conflict between these two courts which should be resolved. Doubt is cast on the tax effect of every reorganization in which a junior creditor or title holder unsuccessfully attempts to seize control.

e. *The Remedial Legislation*

The insolvency of a going business presents problems to the creditors. Many properties, after going into default, produce insufficient income to meet operating expenses, taxes, and prior claims. Sometimes the creditors advance money to meet these expenses; sometimes it can be borrowed. In the final plan of reorganization, it is necessary to make provision for these advances.

The corporate reorganization provisions of section 112(g) of the Internal Revenue Code were not originally designed

to cover this type of reorganization. They envisioned reorganizations involving no assumption of liabilities or cash payments. In *Helvering* v. *Cement Investors,* (1942), 316 U.S. 527, this Court held these provisions inapplicable to reorganizations where liabilities were assumed, cash paid, or other than voting stock issued.

In order to eliminate these technicalities in insolvency reorganizations, and to resolve doubts as to the basis of the property in the hands of the creditors' corporation, Congress enacted sections 112(b)(10) and 113 (a)(22) of the Internal Revenue Code. Under these statutes, the fact that cash is paid, liabilities assumed, or property other than voting stock exchanged, makes no difference. The new corporation takes the basis of the old, subject to prescribed adjustments for such cash, liabilities, or non-voting stock. These statutes are applicable only to taxable years beginning after January 1, 1943, and therefore apply only to the fiscal year of this petitioner ended May 31, 1944.

In the instant case, the trustee and the fee owners made advances to keep the property in operation. In the final plan, the trustee received cash for its advances, and $50,000 of Savoy Hotel Company bonds which it held were cancelled. The fee owners received cash and stock for their advances. A mortgage was placed on the property to raise the cash needed.

Before both the Tax Court and the Court of Appeals, the petitioner urged that the circumstances surrounding the satisfaction of these advances did not take the case out of the regular corporate reorganization provisions of section 112(g). However, petitioner made it clear that it was not relying on these arguments alone. Petitioner strongly urged the applicability of sections 112(b)(10) and 113(a)(22) to the year ended May 31, 1944, regardless of the decision as to the two earlier years.

In spite of the fact that both petitioner and respondent argued the applicability of these provisions on brief, both courts failed to discuss them in their opinions. The Tax Court, on motion for rehearing, did accord them a discussion in a memorandum accompanying the order denying the motion. The Court below, however, although the point was brought squarely to its attention on a petition for rehearing, denied the petition without opinion.

Petitioner feels that the failure of the Court below to consider the applicable statutes has deprived petitioner of an adequate hearing on its case. As Justice Holmes aptly stated, "One of the hardest things to accomplish is to vindicate the obvious". In a tax case, one never knows under what shell the pea lies, but it is all too frequently not under the one you pick up. To narrow the issue down and to bring it squarely before this Court, the only allegation of error urged is the failure of the Court below to pass on the applicability of sections 112(b)(10) and 113(a)(22). By so doing, petitioner hopes to clear out of the case all of the technicalities which those statutes were designed to eliminate. Although it will limit relief to the third year involved, petitioner feels the time has come to take drastic steps in order to have its day in court. Of course, it would not like an adverse decision, but at least it would know it lost on issues joined.

There are thousands of innocent citizens of our country who stand in the same position as petitioner's stockholders. They bought bonds as an investment, and ended up owning real estate. Until the real estate is finally disposed of, they will not know the amount of their gain or loss. Congress enacted legislation to preserve the tax status of the property until its final disposition. This legislation has never been construed by this Court, and the Court below refused to take on the burden. Petitioner submits that the situa-

tion is serious enough to warrant an opinion by the Supreme Court of the United States as to whether the intention of Congress can be carried out.

Conclusion

It is respectfully submitted that the petition for the writ of certiorari should be granted as prayed for.

Respectfully,

RICHARD BENTLY,
JACKSON L. BOUGHNER,
MEYER FIELD,
Counsel for Petitioner Atwood Corporation.

APPENDIX

§ 112(b)(10)—Gain or Loss Not Recognized on Reorganization of Corporations in Certain Receivership and Bankruptcy Proceedings.—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

§ 112(g)—Definition of Reorganization.—As used in this section (other than subsection (b)(10) and subsection (1) and in section 113 other than subsection (a) (22)).—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the

assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

§ 113(a)(22)—Property Acquired on Reorganization of Certain Corporations.—If the property was acquired by a corporation upon a transfer to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, then, notwithstanding the provisions of section 270 of the National Bankruptcy Act, as amended, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such basis shall not be adjusted under subsection (b)(3) by reason of a discharge of indebtedness pursuant to the plan of reorganization under which such transfer was made.

Service on counsel for respondent of a copy of the above brief this ———— day of ————, 1953, is hereby acknowledged.

Attorney for Respondent.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 108

ADWOOD CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 49-62) is reported at 15 T.C. 148. The opinion of the Court of Appeals (R. 76-83) is reported at 200 F. 2d 552.

JURISDICTION

The judgment of the Court of Appeals was entered on December 23, 1952. (R. 83.) Petition for rehearing (R. 85-93) was denied March 10, 1953 (R. 94). The petition for a writ of certiorari was filed June 8, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether taxpayer acquired the hotel property in the manner prescribed by Section 112 (b)(10) of the Internal Revenue Code so as to be entitled under Section 113 (a)(22) to use, as its basis for depreciation for the year ended May 31, 1944, the basis of such property in the hands of the former lessee.

STATUTE INVOLVED

The pertinent sections of the Internal Revenue Code are printed in the Appendix, *infra*, pp. 16-18.

STATEMENT

The facts are reflected in a stipulation of facts (R. 44-48), were stated at some length by the Tax Court in its opinion (R. 50-56), and may be summarized as follows:

Harry L. Pierson and Harriet P. Taylor (hereinafter called the Piersons), owned property in Detroit which they leased for 99 years to two individuals, who agreed to erect a hotel on the property. The lease provided that upon default the Piersons could, after proper notice and the lapse of three months, declare the lease terminated and take possession, in which case all improvements on the premises were to belong to them. On October 20, 1925, the lessees assigned the lease to a corporation known as the Savoy Hotel Company (hereinafter called Savoy). (R. 50-51.)

Savoy and the Piersons subsequently executed a trust indenture to secure first mortgage bonds in the principal sum of $1,450,000. The instrument provided that upon default in carrying out the

terms of the mortgage the trustee could, by a 30-day notice to Savoy and the Piersons, declare the principal of the mortgage due immediately, and that the owners might remedy the default within 30 days and thereby preclude action for enforcement of the mortgage by reason of such default. (R. 51.)

In April, 1929, Savoy was in financial difficulties and unable to pay its rent. On June 12, 1929, the Piersons served upon it a notice to quit. On July 1, 1929, the Piersons entered into an agreement with Savoy by which the Piersons waived all past rent due and all rent for the remainder of 1929 but providing that they could take possession in case Savoy failed to pay the trustee interest falling due after July 1, 1929. Savoy failed to make the required payments and on December 13, 1929, the trustee served notice, in accordance with the trust indenture, of its intention to declare all principal due immediately, to take possession, and to foreclose the mortgage. The Piersons served a 7-day notice to quit on Savoy on December 26, 1929, and took possession of the premises on January 6, 1930. (R. 51-52.)

Savoy immediately brought suit in the state court asking for restoration of possession. The Piersons replied by cross-bill, requesting that the lease be decreed to be lawfully cancelled and terminated. On February 3, 1930, the court entered its decree, after filing an opinion, declaring the Piersons' entry peaceable and in accordance with the provisions of the agreement of July 1, 1929;

that by such entry the Piersons acquired the right of possession for defaults which had occurred but, since the lease contemplated a 90-day delay after default and its provisions remained in force and effect, that confirmation of the Piersons in their title would be granted subject to the right of Savoy to reinstate itself within a period of 90 days from the 26th day of December, 1929. Savoy failed to cure the default and reinstate the lease within the 90-day period allowed by the decree and the confirmation of title in the Piersons, subject to the mortgage, thus became effective. (R. 52-53.)

A committee of bondholders was formed which began negotiations with the Piersons concerning a possible reorganization. On May 20, 1930, the trustee served notice on Savoy and the Piersons declaring the principal of all bonds payable immediately and began foreclosure proceedings in June, 1930. A decree was entered on October 26, 1931, authorizing a sale of the premises forthwith unless the debt was paid. No adequate bid was received and there was no sale until June 11, 1941. Meanwhile, the property was operated first by the Piersons, later by the trustee, and still later by a hotel management company, and the trustee and the Piersons advanced large sums for taxes and operating expenses which became liens on the mortgaged premises prior to the lien of the first mortgage. (R. 53-54.)

On April 18, 1941, ten years after the foreclosure, the Public Trust Commission of Michigan approved a plan of reorganization developed by the bondholders' committee in conjunction with the

Piersons and the trustee. The plan provided for the incorporation of the taxpayer-corporation, which was to purchase the property on foreclosure sale for the benefit of the first mortgage bondholders, to whom stock was to be issued for the bonds. The trustee, the Detroit Trust Company, agreed to accept $110,000 in full settlement of the advances made by it (totaling $103,481.97 and bearing interest at six percent) and for the surrender for cancellation of $50,000 face amount of first mortgage bonds owned by it. The Piersons agreed to accept $65,000 and 27,000 shares of taxpayer's stock in satisfaction of their advances totaling $92,242.60, part of which bore interest at six percent. The plan also provided that, if the taxpayer-corporation was the successful bidder, it would acquire the property subject to the liens of the Piersons and the Detroit Trust Company, because the plan could not be completed until the period of redemption expired, which was six months after sale. The taxpayer-corporation was to borrow $200,000 on a first mortgage on the property and was to use the net proceeds of the loan to make the payments to the Piersons and the Detroit Trust Company. (R. 54-55.)

The taxpayer-corporation was organized and purchased the property at a foreclosure sale on June 11, 1941. The bid price was $400,000, which was paid with first mortgage bonds, $4,942.84 in cash, and a credit of $251,207.20 for the advances of the Piersons and the Detroit Trust Company, which agreed to look solely to the taxpayer-corporation for payment. (R. 55.)

A deed to the premises was delivered to the tax-

payer-corporation on December 11, 1941, upon expiration of the statutory period of redemption. Taxpayer borrowed $200,000 on a mortgage, paid the Detroit Trust Company $110,000 and paid the Piersons $65,000. The holders of $6,500 of the total bonds outstanding objected to the plan and were paid in cash. Upon completion of the plan, taxpayer had 172,000 shares outstanding, 135,800 of which were issuable to the depositing bondholders and 27,000 to the Piersons. (R. 55-56.)

The Commissioner determined deficiencies against the taxpayer-corporation for its fiscal years 1942, 1943 and 1944, ending May 31st. The deficiencies resulted from the Commissioner's determination that the transaction whereby taxpayer acquired the hotel property was not such as to entitle taxpayer to use the cost of the property to Savoy, less depreciation to June 11, 1941, as its basis for depreciation and that taxpayer's own cost basis was $400,000, of which $290,000 is allocable to buildings and depreciable on a useful life basis of 33⅓ years from June 11, 1941. (R. 56.) Both the Tax Court (R. 56-62) and the Court of Appeals (R. 79-83) upheld the Commissioner's determination.

ARGUMENT

This case involves the merits of the taxpayer-corporation's contention that it is entitled to use the basis of an alleged transferor, rather than its own cost, as its basis for the purpose of computing depreciation on the hotel building. On brief in the courts below, taxpayer relied upon Section 113 (a)

(7), (8) and (22) (26 U.S.C. 113 (a)) of the Internal Revenue Code, arguing their applicability on the basis of Section 112 (g) (1) (C), 112 (b) (5), and (10) (26 U.S.C. 112), respectively.[1] Taxpayer now relies only upon Sections 112 (b) (10) and 113 (a) 22 (Appendix, *infra*, pp. 16-18). The court below did not discuss Section 112 (b) (10) and, as taxpayer concedes (Br. 12), it is effective only as to the third taxable year involved in the case.[2] However, under Section 112 (b) (10), as under Section 112 (g) (1) (C), on which taxpayer relied below, one of the requirements is that there be a transfer of property of a corporation. That is a requirement which the court below, in discussing the applicability of Section 112 (g) (1) (C), held was lacking here. It is apparently on the basis of that holding that taxpayer asserts certain conflicts in decisions. (See Pet. 4; Br. 8-11.) The alleged conflicts are nonexistent and there is no basis for taxpayer's assertions (Pet. 4-5; Br. 11-14) that the applicability of Sec-

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[1] Under Section 114 (a) of the Code (Appendix, *infra*, p. 18) the basis for depreciation of property is the basis provided in Section 113 for determining gain upon a sale or other disposition of property.

[2] Section 112(b)(10) was added by Section 121(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and under Section 121(e) of that Act does not affect tax liability for any taxable year beginning prior to January 1, 1943. Taxpayer states (Br. 13) that—

> To narrow the issue down and to bring it squarely before this Court, the only allegation of error urged is the failure of the Court below to pass on the applicability of sections 112(b)(10) and 113(a)(22).

It will also be noted that taxpayer's statement of the question presented (Pet. 4) relates only to Section 112(b)(10) as distinguished from Sections 112(g)(1)(C) and 112(b)(5).

tion 112 (b) (10) presents an important question requiring settlement by this Court. Moreover, the issue as to Section 112 (b) (10) was not even raised in the pleadings, as the Tax Court stated (R. 61-62),[3] and Section 112 (b) (10) seems inapplicable even aside from the holding of the court below that there was no transfer of property of a corporation.[4]

1. Taxpayer's assertion that the applicability of Section 112 (b) (10) presents an important question requiring settlement by this Court (Pet. 4-5) seems to be based on the view that the statute should be construed by this Court (see Br. 13-14). A con-

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[3] For that reason, the Tax Court declined to give consideration to the issue in its opinion (R. 61-62) and, in a memorandum denying taxpayer's motion for reconsideration, again stated that it was under no obligation to decide issues not raised by the pleadings (R. 67). However, in that memorandum the Tax Court went on to state (R. 68) that if it had been called upon to decide the issue it would have decided it against taxpayer on the ground that there was no transfer of property of a corporation, as required under Section 112(b)(10), since Savoy had lost all interest in the property prior to foreclosure.

[4] Section 112(b)(10) applies to a transfer of property of a corporation, pursuant to court order in a foreclosure proceeding, to another corporation organized or made use of to effectuate "a plan of reorganization approved by the court in such proceeding," in exchange solely for stock or securities in such other corporation. The instant plan of reorganization was not developed until 10 years after the Michigan court authorized sale of the property in foreclosure proceedings and it does not appear that the plan of reorganization then formulated was one which was approved by the Michigan court in the foreclosure proceedings. In the court below taxpayer relied upon Exhibit 22V, an order of the Michigan court dated July 28, 1941, which overruled objections and confirmed the sale and report of sale and concluded with a statement that—

> said sale and the report of sale, together with all things pertinent thereto pertaining, be and stand confirmed.

This hardly seems sufficient to constitute the required approval of the plan of reorganization.

struction of the statute is not required. Section 112 (b) (10) contains the same basic requirement as Section 112 (g) (1) (C)—the transfer of "property of a corporation" to another corporation—and, in the case of a transfer of property covered by Section 112 (b) (10), Section 113 (a) (22) permits the acquiring corporation to take the basis "of the *corporation* whose property was so acquired" (italics supplied) (subject to increase in the amount of gain to the transferor). The relief afforded by Section 112 (b) (10) therefore does not include the elimination of the requirement that there be a transfer of "property of a corporation."[5] The Tax Court and Court of Appeals both

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[5] The principal, if not only, relief afforded by the 1943 amendments, which included the addition of Sections 112 (b) (10) and 113 (a) (22), is in the fact that, as taxpayer itself states (Br. 12):

> Under these statutes, the fact that cash is paid, liabilities assumed, or property other than voting stock exchanged, makes no difference. The new corporation takes the basis of the old, subject to prescribed adjustments for such cash, liabilities, or non-voting stock.

This relief is afforded primarily by Sections 113 (a) (22), 112 (d) and (k), rather than by Section 112 (b) (10), for the latter, like Section 112 (g) (1) (C), requires that the transfer of property of a corporation be in exchange "solely" for stock or securities of the other corporation. Sections 113 (a) (22) and 112 (d) have the effect of making the receipt of other property or money immaterial except to the extent that, if the other property or money is not distributed by the receiving corporation pursuant to the plan of reorganization, the transferee takes its transferor's basis increased by the amount of gain to the transferor. Section 112 (k) provides that, if as part of the consideration another party to the exchange assumes a liability of the taxpayer or acquires from the taxpayer property subject to a liability, such assumption or acquisition shall not be considered as "other property or money" unless it appears that the assumption or acquisition was for the principal purpose of avoiding income tax on the exchange or was not for a bona fide business purpose.

held that there was in this case no transfer of property of a corporation, albeit that holding of the court below was made in connection with Section 112 (g) (1) (C). In the light of the facts, the holding is clearly correct and makes Section 112 (b) (10) inapplicable.[6] Accordingly, there is no question in the case, important or otherwise, for this Court to settle with respect to that section.

There is of course no basis for taxpayer's complaint (Br. 12-13) that the court below failed to consider Sections 112 (b) (10) and 113 (a) (22). The holding below that there was no transfer of property of a corporation in exchange for stock was automatically a resolution of the merits of taxpayer's contention as to the applicability of Section 112 (b) (10) even though the court below did not mention that section.

2. The decision below is not in conflict with *Helvering* v. *Limestone Co.*, 315 U.S. 179, nor does it misapply *Bondholders Committee* v. *Commissioner*, 315 U.S. 189. As the court held (R. 80-82), the instant case is distinguishable on its facts from

[6] We do not understand taxpayer to contend that there is a difference as between Section 112(b)(10) and Section 112 (g)(1)(C) in respect of the requirement that there be a transfer of property of a corporation. In any event, the legislative history and pertinent Regulations clearly indicate that Section 112(b)(10), like Section 112(g)(1)(C), applies only to a genuine reorganization where the requisite continuity of interest exists. See S. Rep. No. 627, 78th Cong., 1st Sess., pp. 49-53 (1944 Cum. Bull. 973, 1010-1012); Treasury Regulations 111, Sec. 29.112(b)(10)-1, added by T.D. 5402, 1944 C.B. 229; *Chicago Stadium Corp.* v. *Commissioner*, 13 T.C. 889. And cf. *Mascot Stove Co.* v. *Commissioner*, 120 F. 2d 153 (C.A. 6th), certiorari denied, 315 U.S. 802; *Templeton's Jewelers* v. *United States*, 126 F. 2d 251 (C.A. 6th).

Limestone Co. and is within the doctrine of *Bondholders Committee.*

Limestone Co. holds that the requirement of continuity of proprietary interest as between the old and new corporation is sufficiently satisfied under a plan of reorganization of an insolvent corporation thrown into involuntary bankruptcy proceedings by its creditors, even though the stock of the new corporation is issued to the creditors, rather than to the stockholders, of the old corporation. That holding was based on statements that, in view of the insolvency of the old corporation, the sale of its assets by the bankruptcy trustee did nothing but recognize officially what had before been true in fact and that it conformed to reality to date the creditors' equity ownership of the assets from the time they invoked the processes of law to enforce their rights to full priority. The case involved no loss of interest by the old corporation in its assets, except to a creditors' committee, prior to the transfer of the assets to the newly created corporation. Intervening ownership by the committee, as the Court stated, was one of the separate steps which were "integrated parts of a single scheme" and no more than "intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan" (pp. 184-185).

Bondholders Committee stands for the rather obvious proposition that there is no reorganization consisting of the acquisition by one corporation of substantially all the property of another corpora-

tion when the old corporation has ceased to own the property involved. That case involved an apartment building securing a $500,000 bond issue by the Marlborough Investment Company. Marlborough transferred the property to another corporation and on the date of default on the bonds the property was held by still another corporation and an individual who later quitclaimed their title for $10,025. When the default on the bonds occurred, a bondholders' committee was formed and a plan of reorganization was formulated, pursuant to which there was a foreclosure by and sale to the committee and a transfer of the property from the committee to a new corporation which issued its stock to the bondholders. In holding that there was no reorganization under a statute requiring the acquisition of property of a "corporation" by another corporation, the Court distinguished *Limestone Co.* on the ground that the property involved was not acquired from Marlborough by either the bondholders committee or the new corporation, Marlborough having long since ceased to own the property.

The facts of the instant case are such that *Bondholders Committee* is controlling and that *Limestone Co.* is distinguishable for the same reason it was distinguished in *Bondholders Committee.* In acquiring the hotel property, taxpayer did not acquire property of a corporation, as required for coverage under Section 112 (b) (10). Savoy, the alleged transferor, was a lessee of the property which had ten years previously lost all interest in

the property when, as a result of default in its obligations to its lessors, title subject to the mortgage was confirmed in the Piersons by the Michigan court. The case cannot be assimilated to *Limestone Co.* on the theory that, as part of a reorganization plan, the bondholders committee acquired the property from Savoy and transferred it to taxpayer. The bondholders committee, like taxpayer, did not acquire the property from Savoy, for at the time the bondholders instituted foreclosure proceedings Savoy had lost all interest in the property. Savoy's loss of interest in the property was not a part of the reorganization plan, which was not developed until ten years later and, moreover, the transfer was of a fee simple title, whereas Savoy never had more than a 99-year lease subject to the payment of rent and to cancellation for default. The transferors, to both the bondholders and to taxpayer, were necessarily the Piersons, by reason of the confirmation of title in them by the Michigan court, and the Piersons and Detroit Trust Company by reason of the fact that they held first liens on the property for advances made by them.

Taypayer argues conflict with *Limestone Co.* simply on the basis of the fact that the bondholders "took two steps before their debtor lost title" (Br. 9), consisting of (1) serving a notice of intent to declare the principal of the bonds payable immediately for default and to foreclose and (2) entering into an agreement with the Piersons for the operation of the hotel building. Neither of those ac-

tions shifted any interest in the hotel property. Nor did the notice constitute an invocation of the processes of law to enforce the bondholders' rights. Under the trust agreement, foreclosure proceedings could not be instituted until 30 days following a notice actually declaring the principal of the bonds payable immediately and during the 30-day period the Piersons were entitled to prevent foreclosure by remedying the default. (R. 51.)

3. The instant case is clearly distinguishable from *United States* v. *Warwick Hotel*, 158 F. 2d 961 (C.A. 5th), the facts of which are reflected only in the District Court's opinion, 69 F. Supp. 242 (S.D. Texas). That case involved property owned by a corporation which placed a first mortgage on the property to secure a bond issue and later placed a second mortgage on the property to secure another indebtedness. The company defaulted under both mortgages. The trustee under the first mortgage entered into an agreement with the company for the operation of the property and served notice of default before the trustee under the second mortgage served notice of default but, unknown to the trustee under the first mortgage, the trustee under the second mortgage began foreclosure proceedings which culminated in a sale of the property subject to the first mortgage. A bondholders committee was then formed for the bondholders holding the first mortgage and the committee foreclosed on the property and executed a plan of reorganization pursuant to which the property was transferred to a new corporation

and voting trust certificates were issued to the depositing bondholders. The Fifth Circuit held that the proceedings taken under the first mortgage constituted a reorganization and that *Bondholders Committee* was inapplicable. The fact which distinguishes the case from the present one is that no outside party acquired ownership of the property of the old corporation prior to its transfer to a new corporation, the old corporation having lost title only to the holders of the second mortgage, whose rights were at all times subject to the rights of the holders of the first mortgage. A decision based on such facts is not in conflict with a decision based on facts which clearly make *Bondholders Committee* controlling.

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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JULY, 1953.

APPENDIX

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(10) [as added by Sec. 121 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gain or Loss not Recognized on Reorganization of Corporations in Certain Receivership and Bankruptcy Proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding,

in exchange solely for stock or securities in such other corporation.

* * * * *

(g) [as amended by Sec. 213 (b) of the Revenue Act of 1939, c. 247, 53 Stat. 862 and Sec. 121 (d) of the Revenue Act of 1943, *supra*] *Definition of Reorganization.*—As used in this section (other than subsection (b) (10) and subsection (1)) and in section 113 (other than subsection (a) (22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change

in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(26 U.S.C. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(22) [as added by Sec. 121 (c) of the Revenue Act of 1943, *supra*] *Property Acquired on Reorganization of Certain Corporations.*—If the property was acquired by a corporation upon a transfer to which section 112 (b) (10), or so much of section 112 (d) or (e) as relates to section 112 (b) (10), is applicable, then, notwithstanding the provisions of section 270 of the National Bankruptcy Act, as amended, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and

such basis shall not be adjusted under subsection (b) (3) by reason of a discharge of indebtedness pursuant to the plan of reorganization under which such transfer was made.

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * * *

(26 U.S.C. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.* — The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

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(26 U.S.C. 114.)

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